

STATE OF MICHIGAN
IN THE SUPREME COURT

CITIZENS INSURANCE COMPANY,

Plaintiff/Appellant,

v

PRO SEAL SERVICE GROUP, INC.,
d/b/a PRO SEAL, INC., a Michigan
corporation,

Defendant/Appellee

and

FLOWSERVE CORPORATION,
A New York corporation, FLOWSERVE
MANAGEMENT COMPANY, a
Delaware corporation, SETH SHORT and
RANDY QUINCY,

Defendants,

and

PRO SEAL SERVICE GROUP, INC.,
d/b/a PRO SEAL, INC., a Michigan
corporation,

Counter-Plaintiff,

v

CITIZENS INSURANCE COMPANY,

Counter-Defendant.

Supreme Court No. _____

COA Docket No. 262759

Lower Court: Oakland County
Circuit Case No. 04-056953-CZ

130099 -
**APPELLEE'S BRIEF IN RESPONSE TO
APPLICATION FOR LEAVE TO APPEAL**

FILED
JAN 9 2006
CORBIN R. DAVIS
CLERK
MICHIGAN SUPREME COURT

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COUNTER-STATEMENT CONCERNING COURT OF APPEALS DECISION

The unanimous decision of the Court of Appeals in this case does not break any new ground on any issue. The same decision has been made in numerous similar cases from other jurisdictions and any different decision would have put Michigan jurisprudence at odds with the rest of the country. Indeed, each issue raised by Citizens in its application to this Court was analyzed by the Court of Appeals in depth with citations to numerous previous decisions. The conclusions made by the Court of Appeals were required by the plain language of the insurance policy, and the facts of this case as applied to a large body of case law. Any other decision would have represented a complete aberration in a substantial body of case law, which has been developed principally in the federal courts over decades.

There is no issue of major significance to Michigan jurisprudence involved in this case. The underlying cause of action involved substantially false allegations of unfair competition, trademark and trade dress infringement/Lanham Act violations and trade secret misappropriation. The complaint was filed in the Federal District Court in Alaska by a company named Flowserve against a Michigan company, Pro-Seal Service Group, Inc. Those issues were intensively litigated and, with the exception of two minor and innocent trademark infringements involving \$1,800.00, the complaint was dismissed while a motion for summary judgment was pending in favor of Pro-Seal.

Federal courts are the most common venues for cases involving trademark, trade dress or Lanham Act claims because the claims are creatures of federal rather than state law. In the past 50 years the number of cases brought in state courts alleging trademark, trade dress or Lanham Act violations have been few and far between. Consequently, Citizens' assertion to this Court that the Court of Appeals decision involves legal principles of major significance to Michigan jurisprudence

is an unfounded exaggeration.

Typically, when there has been an insurance coverage dispute related to a federal trademark, trade dress, Lanham Act or unfair competition claim, and there have been many, that issue is also resolved in the federal courts, even though the question of coverage is generally considered to be one of state law. This is the first reported case in 100 years in Michigan involving the question of how a commercial and an umbrella insurance policy should be applied to allegations of federal trademark, trade dress and Lanham Act violations, and it is unlikely that there will be another such case in Michigan courts for another 100 years because almost 90% of these cases take place and are resolved in federal court. However, in distinction to the paucity of state court decisions, there are numerous federal court decisions on this issue and a substantial body of case law from District Courts all the way to the Supreme Court. Indeed, there are so many previous decisions that support the Court of Appeals decision in this case that they are cited in a separate appendix. (See Appendix A and B)

Citizens' argument that the Court of Appeals Opinion has contorted the language of the insurance policy is groundless and unsupportable. The Court of Appeals Opinion is restrained in its conclusions, while Citizens' arguments to this Court approach a high level of sophistry. The Court of Appeals decided only that Citizens was required to defend Pro-Seal because the substance of the Flowserve Complaint arguably fell within the terms of the policy. The decision is consistent with the rules of construction as laid down in Michigan by this Court and does not represent any departure from existing law.

The commercial policy in question plainly covers claims of trade dress infringement in the black and white words of the policy, and the Court of Appeals found that the substance of the Flowserve Complaint included allegations that would have permitted recovery based upon the theory

of trade dress infringement. An objective reading of the Flowserve Complaint, consistent with the Federal Court Rules, requires this conclusion as the complaint includes allegations that Pro-Seal used packaging and a style of business which imitated Flowserve. The use of distinctive packaging is the classic basis for a claim of trade dress infringement. Indeed, the Lanham Act section cited in the Flowserve Complaint makes specific reference to trade dress infringement (15 USC § 1125 (a)). Consequently, the conclusion made by the Court of Appeals that the Flowserve Complaint raised the issue of trade dress infringement is irrefutably correct. Citizens' assertion that the complaint does not use the words "trade dress," and therefore does not allege a trade dress claim is a superficial and specious argument when the allegations of the complaint clearly set forth the substance of a trade dress action and specifically cite a federal statute which codifies trade dress infringement claims.

The Flowserve Complaint includes paragraphs alleging intentional acts and includes paragraphs alleging acts without any specific description as to whether they were intentional. Citizens wishes to focus on one and ignore the other. However, the law is clear that if a complaint sets forth a theory of recovery that falls within the insurance policy, the duty to defend arises despite the fact that other theories of recovery may not be covered. Technical rules of pleading do not govern this inquiry as the insurance company is required to look behind the pleadings to determine if coverage is possible.

Pleading under the Michigan Court Rules is different than Federal Rules of Civil Procedure. Under federal rules a complaint is merely required to factually state a claim. It is not necessary to plead each legal theory or use any special words to draw legal conclusions which may apply to the factual allegations. All that is necessary is that factual allegations are made that give rise to a claim for relief. Construed under federal rules of pleading the Flowserve Complaint includes theories of

innocent and intentional trade dress and trademark infringement, innocent and intentional Lanham Act violations, and innocent and intentional unfair competition claims. Evidence would have been admissible on each theory. Jury instructions would have been given for each theory if the case had been submitted to a jury. This is a matter that should be virtually incontestable, and the inescapable result is that the allegations of the complaint clearly fall within the terms of the policy. The legal standard to be applied is whether the allegations “arguably” fall within the terms of coverage. There is nothing that is contorted by the Court of Appeals in the determination of the fact or in the conclusion. Indeed, the Court of Appeals addressed each issue raised by Citizens, and simply found against them based upon a thorough review of the law and the facts.

Citizens subtly seeks to blur the distinction between an intention to commit an act and the subjective knowledge that the results of the act violate the rights of another and will cause an injury. In the first place, as the Court of Appeals recognized, intention or scienter is irrelevant to a finding of infringement of trademark, trade dress or the Lanham Act, which covers both. Flowserve was not required to prove that Pro-Seal acted with any particular intention as a prerequisite to recovery. All that was necessary for Flowserve to prove under the Lanham Act was that Pro-Seal placed an article in commerce with a trademark or trade dress that was confusingly similar to a valid trademark or trade dress owned by Flowserve and that there was resulting confusion by particular customers or the marketplace in general as to the source of the goods or services being delivered. The Flowserve Complaint cites the Lanham Act section which covers both trademarks and trade dress. Therefore, the Flowserve Complaint arguably sets out a cause of action that does not require the commission of any act with the knowledge that the act would cause an injury. This cause of action is clearly within the definition of an “advertising injury” as defined in the insurance policies. If Flowserve

offered proof of the infringement without any evidence of intention, knowledge or willfulness, then they would have recovered their damages. The fact that the complaint also includes allegations that the infringement was intentional or willful does not change the nature of the cause of action or require Flowserve to prove an intentional infringement lest they lose the entire case.

More importantly, the insurance policy in this case includes an exclusion only for those acts which are committed with the subjective knowledge by the insured that the act violated the rights of another when it was committed and that the act would cause a personal or advertising injury. This is a very narrow exclusion. An allegation that an act of trademark or trade dress infringement was committed intentionally, which is generally made in all such litigation for the purpose of enhancing a claim for damages, is not the same as saying that the insured had subjective knowledge that the act violated the rights of another and would cause an injury. The distinction between the subjective knowledge that an action will violate the rights of another and cause an injury, and an allegation that an act was committed intentionally is elementary and beyond argument.

A person may run a stop sign intentionally because they were in a hurry without subjectively intending to violate another's rights or cause any injury. Running the stop sign may have been an intentional act, but intending to run a stop sign with the specific and subjective knowledge that another car is coming and that an injury was going to occur is completely different. Placing an article in commerce with a certain mark or trade dress is an intentional act. However, if the insured does not subjectively believe that the mark or trade dress violates the rights of another or does not believe that it will cause injury, then the exclusion does not apply. Pro-Seal certainly did not believe that they were violating anyone's rights or causing any injury when they were simply repairing mechanical seals owned by and as directed by the customer. If they did not believe that they were

violating another person's rights, then the exclusion does not apply, and a plaintiff's simple allegation that an act was intentional, knowing or willful, when recovery may be still be obtained without any proof of an intentional, knowing or willful act, is not sufficient to exclude a person from insurance coverage. If the law were as Citizens contends, a plaintiff could completely preclude insurance coverage by the use of strategic pleading and a single theory of recovery which may not be covered by the policy would override many theories of recovery which are covered by the insurance policy.

Pro-Seal asks that the Application filed by Citizens be denied. The decision of the Court of Appeals is not clearly erroneous, but is clearly correct. Furthermore, there is no issue involving any principle of major significance to Michigan jurisprudence.

COUNTER-STATEMENT OF ISSUES

1. Did the decision of the Court of Appeals finding that the allegations made in the Flowserve Complaint arguably fell within the terms of the commercial insurance policy issued by Citizens raise issues which involve principles of major significance to Michigan jurisprudence.

The Court of Appeals and Pro-Seal would answer “No.”

Citizens would answer “Yes.”

2. Was the decision of the Court of Appeals finding that the allegations made in the Flowserve Complaint arguably fell within the terms of the commercial policy clearly erroneous causing a material injustice?

The Court of Appeals and Pro-Seal would answer “No.”

Citizens would answer “Yes.”

3. Was the decision of the Court of Appeals finding that the exclusionary clause was inapplicable to the facts of this case clearly erroneous causing a material injustice?

The Court of Appeals and Pro-Seal would answer “No.”

Citizens would answer “Yes.”

STATEMENT OF FACTS

This is an action for a declaratory judgment. The facts submitted below are the principal facts that were submitted to the circuit court by brief and affidavits in a motion for summary disposition and a motion for reconsideration.

Pro-Seal Service Group, a Michigan corporation (Pro-Seal) has been insured by Citizens Insurance Co. (Citizens) for many years. Pro-Seal sought a declaration that the commercial and umbrella insurance policies purchased for the protection of its business required Citizens to provide a defense and to provide coverage for a lawsuit (the Flowserve Lawsuit) filed against it in Alaska by Flowserve Corporation, a New York corporation. The Flowserve Lawsuit included allegations of trademark and trade dress infringement and referenced the Lanham Act. Lanham Act section 43(a), (15 USC § 1125) includes a codification of certain common law trade dress and trademark doctrines, and other theories of unfair competition and false advertisement that are based on an allegation that a misleading representation has been made regarding the origin of certain products or services that causes confusion. 15 USC § 1125 (a), which is cited in the Flowserve Complaint, specifically includes a reference to actions for trade dress infringement. The Alaskan Unfair Competition statute is similar to the Lanham Act. (AS 45.50.471)

Citizens refused to provide a defense to the action, sought a determination that they were not required to provide a defense and a declaration that there was no coverage.

Both parties filed motions for summary disposition. The motion brought by Pro-Seal was denied and the motion brought by Citizens was granted. Interestingly, the decision made by the Circuit Court assumed that the insurance policy provided coverage, but found that an exclusionary clause relieved the insurance company of its duty to defend. Neither the Plaintiff nor the Defendant

had argued that the exclusionary clause was applicable in the counter motions for summary disposition. Pro-Seal appealed the denial of its motion for summary disposition and the granting of Citizen's Motion, and the Court of Appeals reversed the Circuit Court in a unanimous per curiam decision.

Pro-Seal obtained its own counsel to defend itself in the Flowserve Lawsuit, and after the expenditure of a tremendous amount of time and effort, Pro-Seal was successful in terminating the Flowserve Lawsuit while this action was pending. (Settlement Agreement, Exhibit 8)

Pro-Seal

Pro-Seal is in the business of selling and repairing mechanical seals that are used in high temperature and extreme pressure environments such as are found in oil production and drilling and on the Alaskan North Slope. Pro-Seal is not a manufacturer of mechanical seals. They are a distributor. They sell mechanical seal products manufactured by others and they sell repair services performed by their own employees. As a result of their expertise in the industry, Pro-Seal has developed a substantial niche in the repair marketplace and will, in effect, "re-build" an existing seal for a fraction of the cost of a new seal. A new mechanical seal may sell for as little as \$50 or as much as \$250,000. (Pro-Seal Brief in Support of Motion for Summary Disposition, p 1, Affidavit of Bruce McCartney, Exhibit 3)

A Pro-Seal re-built seal may offer improved components which are manufactured by companies other than the original manufacturer of the seal to enhance its strength and durability or the seal may be rebuilt in a "like new" or original condition. On occasion an end user may specify that particular components be used in the seal that are not manufactured by the original manufacturer (OEM) of the seal in order to make an improvement in the original product or make it more suitable

for a particular use based upon the end user's experience. (Pro-Seal Brief in Support of Motion for Summary Disposition, p 1-2, Affidavit of Bruce McCartney, Exhibit 3)

In this case, OEM customers such as Connoco Oil Co and British Petroleum (BP) requested Pro-Seal to make repairs and modifications to mechanical seals which they had originally purchased from Flowserve. To make an analogy to the automobile business, an owner may hire a specialized repair shop to rebuild the GM engine that came with his car to improve its horsepower or improve performance, or may seek to make more subtle performance improvements by changing specific components such as changing the water pump to a brand other than the OEM to increase coolant flow. (Pro-Seal Brief in Support of Motion for Summary Disposition, p 2, Affidavit of Bruce McCartney, Exhibit 3 and the Conoco-Phillips and BP Affidavits, Exhibit 7) Improvements made to a GM engine at the direction of the owner of the vehicle do not require that the repair shop take the GM name off the product.

There are substantial benefits for an end user in having a worn seal replaced with a rebuilt seal where the end product is more durable than the original, and it is obtained at a fraction of the cost of a new seal. Obviously, a worn-out \$700 seal would be replaced with a new seal, but on the high end products the cost of rebuilding an existing seal can be as small as 20% of the cost of a new seal and the end product may have enhanced performance characteristics. (Pro-Seal Brief in Support of Motion for Summary Disposition, p 2, Affidavit of Bruce McCartney, Exhibit 3)

Flowserve

Flowserve is a large manufacturer of mechanical seals. They also operate a repair business for their worn mechanical seals, where they use only what they call "Flowserve" parts, which may actually be manufactured by other companies. They also have a network of dealers who are

“authorized” to repair Flowserve seals with Flowserve parts. Flowserve has sought to expand their repair business especially in the area of repairing mechanical seals manufactured by its competitors. (Pro-Seal Brief in Support of Motion for Summary Disposition, p 2, Affidavit of Bruce McCartney, Exhibit 3)

Competition

Pro-Seal and Flowserve are competitors in both the sale of new seals and in the repair of worn seals. Pro-Seal repairs or rebuilds seals from all manufacturers and now that Flowserve is seeking to expand their repair business in the area of competitive seals, Pro-Seal and Flowserve have become serious competitors in the repair business as well. However, since Flowserve is a manufacturer and Pro-Seal is not, Pro-Seal purchases the parts it uses from many different manufacturers. In the past, Pro-Seal purchased component parts for mechanical seals manufactured by the Flowserve Corporation directly from Flowserve dealers. However, Flowserve refused to sell any parts to Pro-Seal for approximately the past two years in order to restrain Pro-Seal’s ability to compete with them. (Pro-Seal Brief in Support of Motion for Summary Disposition, p 2-3, Affidavit of Bruce McCartney, Exhibit 3) With the dismissal of the Flowserve Lawsuit that practice was compelled to be changed. (Settlement Agreement, Exhibit 8)

The genesis of this case began in June, 2003, when two Flowserve mechanical seals that had been repaired and rebuilt by Pro-Seal were sitting on a shelf at the Roteq distribution center in Alaska. Roteq is a third party vendor in Alaska engaged in the distribution and sale of mechanical seals. (Flowserve Complaint, Para. 22 (d) & (e), Exhibit 6) The repaired Flowserve seals were shipped by Pro-Seal to Roteq in distinctive Flowserve re-usable packaging with the name Pro-Seal placed on the outside with a prominent red label which displayed the location and contact

information for Pro-Seal as well as a product description and testing information performed on the product. (Affidavit of Bruce M. McCartney, Pro-Seal Brief in Support of Motion for Summary Disposition, p 5-6, Exhibit 3) The exterior packaging also contained the Flowserve trademark. An employee of Flowserve observed the Flowserve packaging (trade dress) with the Pro-Seal advertisement as it was open for anyone to see on the Roteq premises before Roteq had delivered the products to the customer. (Flowserve Complaint, Para. 22 (d) & (e), Exhibit 6) The Flowserve employee, who was involved in the sale of such products, knew that the product contained inside was not a seal that had been repaired by Flowserve because of the clear advertisement on the face of the packaging that the repair had been performed by Pro-Seal. In the words of the Flowserve Complaint, Flowserve then “intercepted” the Pro-Seal repaired seal and the box in which it was contained. [Flowserve Complaint, Para 22 (d) & (e)] In the words of Pro-Seal, Flowserve converted and stole the seals while they were in transit to a customer who had specifically directed Pro-Seal to make certain repairs and had provided Pro-Seal with the re-usable container.

Although a person who is not familiar with trademark or trade dress law may consider the above paragraph sufficient to sustain an allegation of trade dress infringement or a Lanham Act violation, exactly the opposite is true. There is no infringement or violation as the customer who owned both the product and the packaging has the authority to repair the product to its own specifications and may use the re-usable shipping container for repair purposes. Pro-Seal has a complete defense to the allegations. A good analogy would be packing a Gateway computer in its original distinctive box and shipping it to a repair shop. After fixing the computer, the repair shop may re-pack the computer into the same box and ship it back to the customer. Superficially this may appear to be trade dress and trademark infringement under the Lanham Act, but in substance there

is no violation.

The Flowserve Lawsuit

On October 15, 2003, four months after the incident at Roteq, Pro-Seal was served with a Complaint filed in the U. S. District Court in Alaska by Flowserve Corporation. A copy of the Flowserve Complaint is attached as Exhibit 6 and will be referred to as the "Flowserve Complaint." The Flowserve Complaint is 32 pages long with 61 paragraphs. It alleges, among other things, that Pro-Seal created confusion in the marketplace by imitating or infringing trademarks, product marks, and by using trade secrets, blueprints, engineering drawings, packaging materials, and sales related conduct (trade dress) which misrepresented Pro-Seal products as being Flowserve products in violation of Flowserve product trademarks, trade names and the Lanham Act (which specifically encompasses claims for trade dress infringement). (Flowserve Complaint, see particularly paragraphs 19-25, Exhibit 6). The complaint alleged that Pro-Seal was unfairly competing with Flowserve through these various devices and misrepresenting to the public and to particular customers that Pro-Seal products and services were Flowserve products and services. (Flowserve Complaint, paragraph 19, Exhibit 6). The Flowserve Complaint sought damages and an injunction prohibiting the use or imitation of any Flowserve trademark, packaging, drawings, etc. (i.e., trade dress) to "market, advertise or identify" a Pro-Seal product. (Flowserve Complaint, Paragraph 59 (v), Exhibit 6).

The Flowserve Complaint contains Counts entitled as follows:

- Count I-False Representations in Violation of Lanham Act Section 43(a)(1)(A)
- Count II-Unfair Competition under Alaska Law
- Count III-Trademark Infringement in Violation of Lanham Act Section 32(1)
- Count IV-Trademark Counterfeiting in Violation of Lanham Act Section 32(1)

Count V-Trademark Infringement under Alaska Law
Count VI-Trade-Secret Misappropriation under Alaska Law
Count VII-Application for Preliminary and Permanent Injunction

On November 25, 2003, Pro-Seal filed an answer to the complaint denying all of the substantive allegations and setting forth a counterclaim. On December 19, 2003, Pro-Seal notified Citizens of the lawsuit and requested them to provide a defense. Three months later, Citizens declined to provide a defense in one letter with two different dates, one of which was March 17, 2004 and the other was March 15, 2004 (Exhibit 5)

The End of the Flowserve Lawsuit

After more than a year and a half of intense litigation during which Flowserve attempted to spend Pro-Seal into oblivion, Pro-Seal was able to obtain affidavits from the customers who made up the principal customer base in the marketplace. (Exhibit 7) The affidavits destroyed the principal allegations made by Flowserve, raised the specter that Flowserve had rigged a test conducted on a Pro-Seal repaired seal so that it would fail, and had manipulated half-truths in the Complaint to mislead those who were not familiar with the operations of the marketplace. Pro-Seal filed a Motion for Summary Judgment that was 100 pages long in the Federal District Court based upon those affidavits. After a two day facilitation session conducted by a retired Federal District Judge and while the Motion for Summary Judgment was pending, the entire Flowserve Complaint was dismissed by stipulation and Pro-Seal acknowledged two inadvertent trademark infringements with a value of \$1,800. (Settlement Agreement, Exhibit 8)

The two trademark infringements which Pro-Seal acknowledged involved a product which was purchased by Pro-Seal from a major seal manufacturer for which Pro-Seal is a distributor. The seals were sold for \$900 each under the name "P-50," which is a product name used by Flowserve

and which was also used by the manufacturer who supplied Pro-Seal. It is not a registered trademark. After hundreds of hours of work, the 32 page - 61 paragraph complaint filed by Flowserve, which falsely alleged that Pro-Seal attempted to trade off Flowserve's style of doing business and trade dress by imitating Flowserve methods and products and stealing their trade secrets, was dismissed with an acknowledgment that there were two inadvertent, minor and immaterial trademark infringements in the amount of \$1,800. (Settlement Agreement, Exhibit 8)

The Insurance Policies

There are two insurance policies involved in this case. Citizens issued a commercial general liability package insurance policy, No. 01-MPC-0009677-08 (the "Commercial Liability Policy"), naming Pro-Seal as an insured for the period of May 1, 2001/2003. (Exhibit 1) Citizens also issued an umbrella policy, No. CC 0019797 (the "Umbrella Policy"), naming Pro-Seal as an insured for the period of May 1, 2001/2003. (Exhibit 2)

The Commercial General Liability Policy at issue provides in Section 1(a) under the heading "Coverage B, Personal and Advertising Injury Liability" as follows:

We will pay those sums that the insured becomes legally obligated to pay as damages because of "personal and advertising injury".

"Advertising Injury", as defined in Section V, paragraph 14, of the Commercial General Liability Policy includes a group of torts, which by their nature require some element of intention. Section V, paragraph 14 is split into a multitude of subparagraphs which include the following provisions all of which involve torts requiring an intentional act:

"Personal and advertising injury" means injury, ... arising out of one or more of the following offenses:

- a. false arrest, detention or imprisonment;

- b. Malicious prosecution;
- c. The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling, or premises that a person occupies, committed by or on behalf of its owner, landlord or lessor;
- d. Oral or written publication of material that slanders or libels a person or organization or disparages a person's or organizations's goods, products or services;
- e. Oral or written publication of material that violates a person's right of privacy
- f. The use of another's advertising idea in your "advertisement", or
- g. Infringing upon another's copyright, trade dress or slogan in your "advertisement."

"Advertisement" is defined in the Commercial General Liability Policy as:

"Notice that is broadcast or published to the general public or specific market segment about your goods, products or services for the purpose of attracting customers or supporters."

The provisions of the Umbrella Policy are slightly different from the Commercial Policy.

"Advertising Injury" as defined in the Umbrella Policy is found at page 9, Section III, A and includes the following intentional torts:

"Injury caused by one or more of the following offenses committed during the policy period in the course of advertising your goods, products or services:

- 1. Oral or written publication of material that slander or libels a person or organization or disparages a person's or organization's goods, products or services.
- 2. Oral or written publication of material that violates a person's right or privacy
- 3. Misappropriation of advertising ideas or style of doing business; or
- 4. Infringement of copyright, title, or slogan.

The Commercial General Liability Policy includes under named insureds, employees of the insured, which are included in the Umbrella Policy as being covered by the Commercial General Policy.

The Decision by the Court of Appeals

The opinion issued by the Court of Appeals began with an examination of the scope of the coverage provided by the policy based upon its specific language. It analyzed the allegations of the

Flowserve Complaint and looked at the substance of the injury that was alleged to have occurred. The Court concluded that the substance of the complaint included the doctrine of trade dress as a theory on which recovery could be based, and that the claimed injury arguably fell within the definition of an advertising injury. After finding that there was a reasonable argument that coverage existed, the Court of Appeals examined the exclusionary clause and found that it was not applicable for the reason that the Complaint included both intentional and non-intentional acts, and Flowserve could have recovered without proving that any act was committed intentionally. The Court of Appeals did not address the question as to whether an allegation of an intentional act was the same as knowledge that a right is being violated and damage would occur because it was not necessary to the decision, and did not address the umbrella policy for the reason that it found liability under the commercial policy.

**STANDARD FOR GRANTING LEAVE TO APPEAL AND
STANDARD FOR REVIEW IN SUBSTANTIVE APPEAL**

The standard for granting leave to appeal is correctly set forth by Citizens in quoting MCR 7.302 (3) and (5) as follows:

- (3) the issue involves legal principles of major significance to the state's jurisprudence...
- (5) in an appeal from a decision of the Court of Appeals, the decision is clearly erroneous and will cause material injustice or the decision conflicts with a Supreme Court decision or another decision of the Court of Appeals;

However, this is an appeal from a decision of a motion for summary disposition and involves matters of law which would be reviewed on a de novo basis in the event that the court determines that it would accept the case for consideration. *Henderson v State Farm Fire & Casualty Co.*, 460 Mich 348, 353; 596 NW2d 190 (1999).

ARGUMENT I

THE DECISION OF THE COURT OF APPEALS FINDING THAT THE ALLEGATIONS MADE IN THE FLOWSERVE COMPLAINT ARGUABLY FELL WITHIN THE TERMS OF THE COMMERCIAL INSURANCE POLICY ISSUED BY CITIZENS DOES NOT RAISE ISSUES WHICH INVOLVE PRINCIPLES OF MAJOR SIGNIFICANCE TO MICHIGAN JURISPRUDENCE

There is little if any litigation in Michigan courts concerning trademarks, trade dress and Lanham Act claims. Although the decision of the Court of Appeals has been marked for publication, the reason has more to do with the amount of time and effort that was required to gain an understanding of the law in this area rather than having any issues of great legal importance. The briefs, exhibits and cited authorities which were submitted to the Court of Appeals were voluminous, and there was a significant amount of time and effort expended by the Court of Appeals in order to acquire the expertise to write a well reasoned opinion. The substantial effort made by the Court of Appeals is exhibited in the opinion, and it is worthy of publication. However, to argue that it breaks new ground, establishes any new principles of law or affects Michigan jurisprudence on a scale wider than the scope of this case is simply not true.

The Court of Appeals decision is consistent with the great body of law that has already been established finding that claims involving alleged trademarks and/or trade dress violations, and Lanham Act violations fall within the terms of the commercial and/or umbrella policies issued by Citizens. See Appendix A and B. The arguments made in the Citizens' brief are more directed at the disagreement Citizens has with the findings of the Court of Appeals, not with the legal principles that have been applied. Indeed, there appears to be substantial agreement with respect to the principles that should be applied.

Michigan law is well-settled regarding the interpretation of insurance policies, *American Bumper & Mfg Co v Hartford Fire Ins Co*, 207 Mich App 60, 67; 523 NW2d 841 (1994), aff'd 452 Mich. 440; 550 NW2d 475 (1996) and summarized in the case of *Radenbaugh v Farm Bureau General Ins*, 240 Mich App 134, 137-139; 610 NW2d 272 (2000). This is a long quote, but it is applicable to this case in all its aspects.

It is well settled that "if the allegations of the underlying suit arguably fall within the coverage of the policy, the insurer has a duty to defend its insured." *Royce v Citizens Ins Co*, 219 Mich App 537, 543; 557 NW2d 144 (1996), citing with approval *American Bumper & Mfg Co v Hartford Fire Ins Co*, 207 Mich App 60, 67; 523 NW2D 841 (1994), aff'd 452 Mich. 440; 550 NW2D 475 (1996). Further, [a]n insurer has a duty to defend, despite theories of liability asserted against any insured which are not covered under the policy, if there are any theories of recovery that fall within the policy. *Dochod v Central Mutual Ins Co*, 81 Mich App 63; 264 NW2d 122 (1978). The duty to defend cannot be limited by the precise language of the pleadings. The insurer has the duty to look behind the third-party's allegations to analyze whether coverage is possible. *Shepard Marine Construction Co v Maryland Casualty Co*, 73 Mich App 62; 250 NW2d 541 (1976). In a case of doubt as to whether or not the complaint against the insured alleges a liability of the insurer under the policy, the doubt must be resolved in the insured's favor. 14 Couch on Insurance 2d, § 51:45, p 538. [*Western Casualty & Surety Group v Coloma Twp*, 140 Mich App 516, 520-521; 364 NW2d 367 (1985), quoting with approval *Detroit Edison Co v Michigan Mut Ins Co*, 102 Mich App 136, 141-142; 301 NW2d 832 (1980).] Also, the following fundamental principles of insurance law apply: It is well settled in Michigan that an insurer's duty to defend is broader than its duty to indemnify. *Auto-Owners Ins Co v City of Clare*, 446 Mich 1, 15; 521 NW2d 480 (1994). In order to determine whether an insurer has a duty to defend its insured, this Court must look to the language of the insurance policy and construe its terms to find the scope of the coverage of the policy. *Arco Industries Corp v American Motorists Ins Co*, 448 Mich 395, 402; 531 NW2d 168 (1995). Generally, an insurance policy is a contract between the insurer and the insured. *Auto-Owners Ins Co v Churchman*, 440 Mich 560, 566; 489 NW2d 431 (1992). If a trial court is presented with a dispute between these parties over the meaning of the policy, the trial court must determine what the agreement is and enforce it. *Kass v Wolf*, 212 Mich App 600, 604; 538 NW2d 77 (1995). When determining what the parties' agreement is, the trial court should read the contract as a whole and give meaning to all the terms contained within the policy. *Churchman*, *supra* at 566. The trial court shall give the language contained within the policy its ordinary and plain meaning so that technical and strained constructions are avoided. *Hosking v State Farm Mutual Automobile Ins Co*, 198 Mich App 632, 633-634; 499 NW2d 436 (1993). A policy is ambiguous when, after reading the entire document, its language can be reasonably understood in different ways. *Trierweiler v Frankenmuth Mutual Ins Co*, 216 Mich App 653, 656-657; 550 NW2d 577 (1996). If the

trial court determines that the policy is ambiguous, the policy will be construed against the insurer and in favor of coverage. *Heniser v Frankenmuth Mutual Ins Co*, 449 Mich 155, 160; 534 NW2d 502 (1995).

The principles applied by the Court of Appeals in this case are completely consistent and rely the law as set forth in *American Bumper, supra*.

With respect to the umbrella policy involved in this case, which the Court of Appeals did not reach, decisions made by the Federal Appellate Courts in the 3rd Circuit, 4th Circuit, and the 11th Circuit would require coverage. *Cat. Internet Servs. Inc. v Providence Washington Ins.*, 333 F3d 138 (3rd Cir, 2003), *State Auto Property v Travelers Indemnity Co.*, 343 F3d 249, 257 (4th Cir, 2003), *Hyman v Nationwide Mut. Fire*, 304 F3d 1179, (11th Cir, 2002). The 2nd Circuit and 5th Circuit have determined that coverage is provided by the same language for trade dress infringement. *Gemmy Industries Corp v Alliance General Ins*, 190 F Supp 2d 915, *affirmed*, 200 F3d 816 (5th Cir, 1999); *R.C. Bigelow, Inc. v Liberty Mut. Ins. Co*, 287 F3d 242, 247-48 (2nd Cir, 2002).

Citizens argues that this is the first published case in Michigan in which a commercial insurance policy has been applied to trademark, trade dress or Lanham Act claims. This is a true statement, but it fails to recognize that there are perhaps fifty reported cases across the country where courts have found that insurance policies very similar and sometimes exactly the same as the policies in this case have been found to provide coverage for claims just like the instant case. (See Appendix A & B) Against what should be considered to be overwhelming authority Citizens cites one case from the Sixth Circuit to argue that there is a split of authority. *Advance Watch Co, Ltd v Kemper Natl Ins Co*, 99 F3d 795 (6th Cir, 1996) This argument is not well founded as the *Advance* decision has no application to the present case and a more detailed analysis demonstrates that even the *Advance* case would be fatal to the position taken by Citizens.

Advance was a case in which Cross Pens claimed a Pierre Cardin pen was an infringement of the Cross trade dress. The Pierre Cardin distributor used a picture of the pen in an advertisement and was sued by Cross. The distributor submitted the matter to his insurance company who refused to defend the case. The 6th Circuit held that there was no coverage for infringement of trade dress because the policy did not specifically state that it covered claims for trade dress or trademark infringement.

Advance was decided on the basis that trademark and trade dress claims are functional equivalents (See fn 3), which is true as the Court of Appeals noted in the instant case. The 6th Circuit looked for the words trademark or trade dress in the policy, but found that those words were not expressly included in the insurance policy. The fact that the policy at issue in *Advance* did not include an express reference to “trade dress” represents a material and compelling factual difference with the policy at issue in this case. The policy at issue in this case expressly includes coverage for infringement of “trade dress” in paragraph 14, subparagraph g as follows:

- g. Infringing upon another’s copyright, **trade dress** or slogan in your “advertisement.”

This clause did not exist in the policy at issue in the *Advance* case.

The *Advance* case was determined on the basis that the policy did not provide coverage because the words were not used in the policy, not on the supposition made by Citizens that trade dress infringement does not constitute an advertising injury. Citizens’ brief has the cart before the horse. If the insurance policy at issue in this case had been at issue in *Advance*, then the insured would have won the case because coverage for trade dress infringement is clearly and unambiguously provided in the policy. What the 6th Circuit could not find in its narrow reading of

the policy, the words "trade dress," are in the instant policy in black and white.

Although it is not applicable to this case, the *Advance* decision has been roundly criticized and rejected by other courts. *EKCO Group, Inc. v Travelers Indemnity Co.*, 273 F3d 409 (1st Cir. 2001); *Cat. Internet Services, supra*. In *Hyman, supra*, the Court stated as follows:

The majority of courts outside the Sixth and Eighth Circuits to confront this question, including one applying Florida law, have rejected the reasoning of that case. See, e.g., *Frog, Switch*, 193 F.3d at 747 ("*Advance Watch* has been sharply criticized for ignoring the real contours of intellectual property litigation, which often proceeds under a bewildering variety of different labels covering the same material facts.") (citation omitted); *Fid. & Guar. Ins. Co. v Kocolene Mktg. Corp.*, No. 00-1106, 2002 WL 977855, at *9 (S.D.Ind. Mar 26, 2002) (*Advance Watch* is a minority view and is unpersuasive."); *Adolfo House*, 165 F. Supp.2d at 1339-40 (applying Florida law); *CAT Internet Sys. v Providence Wash. Ins. Co.*, 153 F. Supp.2d 755, 761-62 (E.D. Pa. 2001) (following *Frog, Switch*); *Flodine v State Farm Ins. Co.*, No. 99-C-7466, 2001 WL 204786, at *7 (N.D.Ill. March 1, 2001); *Ryland Group, Inc. v Travelers Indem. Co. of Ill.*, No. Civ. A-00-CA-233, 2000 WL 33544086, at *6 n. 9 (W.D.Tex. Oct 25, 2000); *Bay Elec. Supply, Inc. v Travelers Lloyds Ins. Co.*, 61 F. Supp.2d 611, 616-17 (S.D.Tex. 1999); *Am. Employers' Ins. Co. v DeLorme Pub. Co.*, 39 F. Supp.2d 64, 76 (D.Me. 1999) ("The decision in *Advance Watch* is the great exception to the trend under the law. . . ."); *Indus. Molding Corp. v American Mfrs. Mut. Ins. Co.*, 17 F. Supp.2d 633, 638-39 (N.D.Tex.), vacated pursuant to settlement, 22 F. Supp.2d 569 (N.D.Tex. Oct 13, 1998); *Gemmy Indus. Corp. v Alliance General Ins. Co.*, 190 F. Supp.2d 915, 920 (N.D.Tex. 1998) (finding that adopting the reasoning of *Advance Watch* "would circumvent well-established principles of contract construction"); *Energex Sys. Corp. v Fireman's Fund Ins. Co.*, No. 96-CV-5993, 1997 WL 358007, at *3 (S.D.N.Y. June 25, 1997); see also *Dogloo, Inc. v Northern Ins. Co. of N.Y.*, 907 F. Supp. 1383, 1388-90 (C.D.Cal. 1995) (deciding the issue prior to *Advance Watch*); *Poof Toy*, 891 F. Supp. at 1233; *Union Ins. Co. v Knife Co.*, 897 F. Supp. 1213, 1215-16 (W.D.Ark. 1995); *Sentex Sys., Inc. v Hartford Accident & Indem. Co.*, 882 F. Supp. 930, 941-44 (C.D.Cal. 1995); *J.A. Brundage Plumbing & Roto-Rooter, Inc. v Mass. Bay Ins. Co.*, 818 F. Supp. 553, 558 (W.D. N.Y. 1993), vacated pursuant to settlement, 153 F.R.D. 36 (W.D. N.Y. 1994).[fn9]

We can find no issues in the Opinion written by the Court of Appeals in this case which involve legal principles having any impact on Michigan jurisprudence.

ARGUMENT II

THE DECISION OF THE COURT OF APPEALS FINDING THAT THE ALLEGATIONS MADE IN THE FLOWSERVE COMPLAINT ARGUABLY FELL WITHIN THE TERMS OF THE COMMERCIAL POLICY IS NOT CLEARLY ERRONEOUS AND DOES NOT CAUSE A MATERIAL INJUSTICE

Citizens argues that the Court of Appeals was clearly erroneous in finding that the Flowserve Complaint made allegations that would raise a claim of trade dress infringement, and that there was an “advertising injury” alleged within the terms of the insurance policies. This argument is based primarily on the premise that the words “trade dress” are not used in the complaint, and it requires the words of the complaint to be parsed in a way that ignores their context. Citizens’ brief ignores that the Lanham Act, (15 USC § 1125(a)) is specifically cited in the complaint and the fact that 15 USC § 1125(a) is in part a codification of the common law concerning trade dress, ignores the Federal Rules of Civil Procedure, fails to address the underlying substance of the complaint, which Michigan law requires, and fails to address the standard that should be applied under Michigan law in determining whether the allegations in a complaint fall within the terms of an insurance policy.

The standard to be applied in this inquiry was set forth by this Court in *American Bumper*, at 450-452 and is consistent with the law in most of the 50 states.

“If the allegations of a third party against the policyholder even arguably come within the policy coverage, then the insurer must provide a defense... The duty to defend cannot be limited by the precise language of the pleadings. The insurer has the duty to look behind the third party’s allegations to analyze whether coverage is possible...In a case of doubt as to whether or not the complaint against the insured alleges a liability of the insurer under the policy, the doubt must be resolved in the insured’s favor.”

The classic claim for trade dress infringement involves the packaging of a product or service. *Two Pesos, Inc. v Taco Cabana, Inc.*, 505 US 763, 774; 112 S. Ct. 2753; 120 L. Ed 2d 615 (1992)

was correctly cited by the Court of Appeals. It states that the Lanham Act (15 USC § 1125 (a)), the same section cited by Flowserve in its complaint, creates a cause of action for trade dress infringement. (*Two Pesos* at 780) Packaging and labeling are forms of trade dress and a form of advertisement. *Industrial Molding v Mfrs. Mut. Ins. Co*, 17 F Supp 2d 633 (ND Tex, 1998) They communicate the source of goods and services. They identify the provider of goods and services for the purpose of providing the customer with the information necessary to obtain more of the goods and services.

Flowserve specifically complained that Pro-Seal used packaging that is identical to that which is used by Flowserve with Flowserve's trademark on it and labeled it with the Pro-Seal name. (Complaint, para 22, Exhibit 6) Indeed, the packaging that Pro-Seal used in this instance was not just identical to Flowserve's packaging, it was Flowserve's packaging as it had been sent by the customer who owned it to Pro-Seal so that Pro-Seal would have an appropriate container in which to return the repaired seal. Flowserve attempted to make Pro-Seal's use of the packaging and the placement of a Pro-Seal advertisement directly on the packaging into a trademark/trade dress or Lanham Act violation.

Under the Lanham Act, the use of confusingly similar packaging can be considered a violation of the Act as it is tantamount to false advertising, and it is more than a little odd for Citizens to be arguing that there is no advertisement when its insured is accused of violating a federal act which applies only to advertising. Advertising is inherent in all alleged Lanham Act violations. Advertising is also inherent in packaging which is intended to identify the source of a product, and Citizens' argument that packaging and labeling are not a form of advertisement is simply wrong. (See Appendix A) Furthermore, when it is considered that the genesis of this case arose when an

employee of Flowserve saw Flowserve's distinctive packaging at a third party vendor's place of business with the name Pro-Seal prominently displayed in red to anyone who would look at the item, then the argument made by Citizens loses touch with reality. Flowserve Complaint, para 22 (d) and (e), Exhibit 6. If there had not been an advertisement, then Flowserve would not have known what Pro-Seal was doing. Indeed, the red label used by Pro-Seal is part of its trade dress. There is obviously an advertisement, and advertising injury and a nexus between the advertisement and the injury because the claim is based upon the alleged portrayal or communication by Pro-Seal that its products and services were somehow related to Flowserve and customer confusion was allegedly brought about by the false portrayal.

Citizens argues that the complaint does not use the words "trade dress." Use of the words in this context exalts form over substance. It is the substance of the allegations that must be examined, not the form. The Court of Appeals properly rejected Citizens' arguments to the contrary. (*Ct App Op, p. 4, Radenbaugh v Farm Bureau General Ins*, 240 Mich App 134, 137-139; 610 NW2d 272 (2000)). Citizens did not look behind the pleadings or at the substance. Instead, they parsed words to rob them of their contextual meaning.

Flowserve alleged that Pro-Seal sought to pass off a Pro-Seal product as a Flowserve product by: (1) "representing" that Pro-Seal is associated and authorized by Flowserve, (2) manufacturing and selling "imitations" of Flowserve products, (3) "counterfeiting" Flowserve products, (4) "appropriating" Flowserve's trademarks, (5) "masquerading" as a Flowserve agent, (6) including Flowserve drawings in containers with Pro-Seal products, (7) using distinctive shipping crates which prominently bear the Flowserve name and logo. Certainly, the allegations are sufficient under the Federal Rules of Civil Procedure to have allowed for the introduction of evidence on the theory of

a trade dress infringement and appropriate jury instructions would have been required. If the introduction of evidence at a trial regarding an infringement of trade dress would have been allowed based upon the allegations of the complaint, then trade dress is certainly a possible basis for recovery. If it is arguably a basis for recovery, then the insurance company has as an obligation to defend its insured.

Citizens argues that the complaint does not state that the shipping crate was “distinctive.” Again, Citizens is parsing words. The shipping crate was certainly distinctive because it had Flowserve’s trademark on it and the use of Flowserve’s shipping crate was alleged to be one of the reasons that customers were confused. If the shipping crate was not distinctive, then it could not have been an element of the alleged customer confusion. The packaging used by Flowserve is certainly part of Flowserve’s distinctive trade dress and to argue that a package in which a product is transported is not part of the manufacturers’ trade dress in a case where the complaint cites the Lanham Act section which applies to trade dress flies in the face of the Federal Rules of Civil Procedure and every case that has applied 15 USC § 1125(a). Furthermore, evidence would certainly have been allowable pursuant to the allegations made in the complaint to show that the Flowserve shipping crate on the North Slope of Alaska is just as distinctive as a Coca Cola bottle anywhere in the United States.

The allegation that Pro-Seal was representing itself as associated with Flowserve is also sufficient to encompass the concept of trade dress. The alleged use by Pro-Seal of Flowserve’s trade dress in the form of its distinctive packaging would be evidence to support the allegation that there was a representation as to the source of the goods, i.e., that Pro-Seal was associated with Flowserve. The substance of the Flowserve’s allegation that Pro-Seal represented itself as associated with

Flowserve is clearly based in part upon the doctrine of trade dress infringement, and the Court of Appeals was correct in its conclusion.

As a result of the alleged imitative activities, which certainly constitute a style of doing business, a misappropriation of advertising ideas, and trade dress, all of which are covered by the insurance policies, Flowserve alleges that customers became confused as to the origin of their products. Confusion in the marketplace is the very essence of an advertisement injury. Placing the Pro-Seal name on a distinctive Flowserve shipping container, having it placed at a third party vendor's place of business, and placing it in commerce is an advertisement to the public and to a specific market segment conveying both the origin of the product and name of the provider. It is used by the customer and vendors for repeat business. Even on the customer's inventory shelf, the prominent red label with Pro-Seal's name and the product description is an advertisement.

Flowserve's allegation that the placement of Pro-Seal's red label on a Flowserve shipping container could cause confusion has theoretical merit that only is dissipated by the reality that these particular customers were very sophisticated engineers who had ordered the repairs made and knew that they were dealing with Pro-Seal. If Pro-Seal had not been working under the direction of specific customers, and instead was attempting to sell a rebuilt Flowserve mechanical seal in the manner alleged, then Flowserve's action may not have been dismissed by stipulation because if a customer had been confused as a result of the use of Flowserve's packaging, then there would have been an advertising injury in reality. Indeed, it would be hard to find a better example of a trade dress/Lanahm Act violation where the advertisement caused the injury.

Advertisement is a broad concept as noted by the Court of Appeals, and contrary to Citizens arguments, only a single advertisement is required under the commercial policy. According to the

claims of Flowserve, the public and specific customers were conveyed the idea that Pro-Seal products are the same as Flowserve products by oral, written, verbal and nonverbal communication (advertisements) infringing on Flowserve trade dress and trademarks. As a result of the confusion created by this allegedly misleading communication, Flowserve alleged that it lost sales and its goodwill was been damaged. This is a classic case of trade dress infringement. It is also within the meaning of “style of doing business” and constitutes a misappropriation of advertising ideas as set forth in the umbrella insurance policy. The Court of Appeals conclusion that there was an advertisement, and advertising injury, and a nexus between the advertisement and the injury within the terms of the policies are well founded.

Citizens argues that while trademarks and trade dress may be functional equivalents, as the U.S. Supreme Court held in *Two Pesos*, and the Court of Appeals acknowledged, it is technically possible for there to be an infringement of one without there being an infringement of the other. Citizens criticizes the Court of Appeals finding in this regard. The criticism misses the point that the Court of Appeals also found that the substance of the Flowserve complaint included a claim for trade dress infringement as we have addressed earlier in this brief. Furthermore, the criticism is misplaced.

Trade dress is a broad concept. It can include such diverse things as the labeling, color or shape of a package, which have nothing to do with the product itself, and it can also include the appearance of the product itself. Trademarks are much more narrow in scope and generally involve the name or logo.

The commercial policy in this case includes the broader concept of trade dress, not the narrower concept of trademark. Citizens should admit that in the field of federal intellectual law,

the distinctions between the two concepts are often blurred and go by a wide variety of names. It is often difficult to tell where a trademark ends and trade dress begins, and the Supreme Court's holding that they are functional equivalents is true beyond any question. If they are functional equivalents and the insurance policy includes the broader category by specific reference, it is not logically possible to exclude the narrow category without a specific exclusion or the admission that the policy is ambiguous.

Prior to 1986, the standard liability policy contained a specific exclusion for trademark, trade name and unfair competition claims. The insurance institute amended the standard general liability policy form in 1986, to eliminate the specific exclusions for trademark, trade name and unfair competition coverage. *Industrial Molding, supra*. There was a purpose for the elimination of the exclusion and as the Court in *Industrial Molding* held at page 639:

... a policyholder over time could reasonably infer that claims related to trade dress would not be excluded from a CGL policy, based upon the 1986 revision of the standard form.

The conclusion that the insurance institute intended and accepted as a matter of law the fact that trademark/trade dress coverage is provided pursuant to the phrase "misappropriation of advertising ideas or style of doing business" as stated in the umbrella policy, is inescapable. This is completely contrary to Citizens' arguments that the standard form was amended to exclude trademark coverage. Exactly the opposite is true. If the insurance institute had intended to exclude trademark infringement claims from coverage, then they could have done so by simply writing an exclusion that said; "Trademark infringement claims are excluded." Instead, the standard form was amended and the trademark exclusion was removed. History now demonstrates beyond peradventure that trademark and trade dress infringement coverage is considered standard.

Any claim that an injustice was done in this case is totally wrong. Even if the Court of Appeals had held that the commercial policy did not provide coverage, the argument that there is coverage under the umbrella insurance policy is even stronger, and this represents another fatal flaw in Citizens' application to this Court. There is trademark and trade dress coverage under the umbrella policy, and this coverage represents another basis on which to find both a duty to defend and a duty to indemnify, which was not addressed by the Court of Appeals because it was unnecessary to reach that issue. It represents a completely separate basis for finding that Citizens is obligated to defend and indemnify Pro-Seal and destroys any argument that an injustice was done.

The umbrella policy provides on page 9, section III A 3, that coverage includes a claim for "Misappropriation of advertising ideas or style of doing business." This specific language is not defined in the insurance policy, but has been construed by many courts. The Court in *State Auto Property, supra*, stated:

"The vast majority of courts have concluded that trademark infringement falls within the meaning of "misappropriation of advertising ideas or style of doing business." citing 54 SMU L. R. 1973, 1994 (2001)

Decisions made by the Federal Appellate Courts in the 3rd Circuit, 4th Circuit, and the 11th Circuit are consistent. *Cat. Internet, supra, State Auto, supra, Hyman, supra*. In addition the 2nd Circuit and 5th Circuit have determined that coverage is provided by the same language for the equivalent claim of trade dress infringement. *Gemmy Industries, supra, R.C. Bigelow, supra*. There are so many Federal District Court and State Court decisions that come to the same result that they cannot be listed in a short brief. (See for example *State Auto* at 257)

Trademarks and trade dress are functional equivalents. (*Two Pesos, supra*) They are both symbols used to convey a message. A trademark is a way of marking goods so that they will be

identified with a particular source. *Northam Warren Corp. v Universal Cosmetic Co.*, 18 F2d 774, 774 (7th Cir, 1927) ("A trademark is but a species of advertising, its purpose being to fix the identity of the article and the name of the producer in the minds of people who see the advertisement. . . ."). An effective trademark communicates a message to consumers about the marked goods, which is the essence of advertising, and therefore allegations of trademark infringement arguably allege misappropriation of an advertising idea. See, e.g., *Industrial Molding, supra*, at 637-38 (citing cases to show that this is the majority position). Trade dress fulfills the very same function in the same way and is also covered by Section 43 of the Lanham Act. *Industrial Molding, supra*, at 638. *Two Pesos, supra*.

The reasoning underlying the decisions finding coverage is common sense and plain meaning as the 3rd Circuit makes clear in *Cat. Internet, supra* at 144:

It makes sense that a trademark infringement action would be covered by an insurance policy that applies to 'misappropriation of advertising ideas' because a trademark...- is an advertising idea that may be created and owned, and thus wrongfully taken or 'stolen'."

Trade dress also represents an "advertising idea" or symbol, which seeks to distinguish one manufacturer from another. It is an intellectual property right that may be converted or misappropriated just as much as a trademark.

Trade dress is communicated by color, style, labeling and packaging. Trademarks are communicated by a name or symbol which is many times placed on a package. Where does the trade dress that involves the overall appearance with the packaging of a product end and the trademark that is a part of the packaging begin in such a case? The answer is that there is no clear line between the two. The trade dress in such a case includes the placement of the trademark.

In view of the multitude of cases in which the courts have held that trademark/trade dress coverage is provided under standard insurance policies, it would be beyond any reason or logic to hold that the policies here do not cover the claims made by Flowserve. Certainly, in this case if the Court of Appeals had disagreed with the decisions of five federal appellate courts, that would be cogent evidence of an ambiguity in the policy, and therefore, the most that Citizens can support, if limited by logic, is that there is an ambiguity concerning whether a claim for trademark infringement is covered and in order to do this, we would have to ignore a countless number of prior decisions. There can be no ambiguity as to trade dress as it is specifically covered in the commercial policy and should be carried over to the umbrella policy.

Citizens also demonstrates a fundamental misunderstanding of the use of pleadings in a Federal case. (See *Cincinnati Ins v Eastern Atlantic Ins.*, 260 F3d 742, 745 (7th Cir, 2001) FRCP 8 provides that a complaint requires a short and plain statement of the grounds on which jurisdiction is based, “a short and plain statement of the claim showing that the pleader is entitled to relief” and a demand for relief. There is no requirement to set out separate theories or draw legal conclusions. Based upon the complaint filed by Flowserve, it is certainly arguable that they would have been able to present evidence and been entitled to jury instructions for trade dress infringement.

In this case there is no question concerning the application of the commercial policy to a trade dress claim because it states in plain English that it covers trade dress. There is equally no well laid argument concerning the application of the umbrella policy to both trademark and trade dress claims. Therefore, if we apply the normal rules of construction to the evidence, the result is clear and the Court of Appeals decision is correct.

ARGUMENT III

THE DECISION OF THE COURT OF APPEALS FINDING THAT THE EXCLUSIONARY CLAUSE WAS INAPPLICABLE TO THE FACTS OF THIS CASE WAS NOT CLEARLY ERRONEOUS AND DOES NOT CAUSE A MATERIAL INJUSTICE

The Court of Appeals found that the exclusionary clause did not apply because the Flowserve Complaint would have allowed for recovery based upon an infringement which was innocent, inadvertent, negligent or reckless. (Ct App Op. p. 6.) The Court of Appeals found that it was unnecessary to address the issue as to the requisite knowledge that would be required in order to apply the exclusion because under federal law Flowserve would have been entitled to recover damages even if no proof of an intentional act had been offered. The Court of Appeals decision is consistent with the very large body of law that exists on this issue.

There are many federal courts that have addressed the precise issue as to whether an allegation of willfulness or knowledge in a trademark/trade dress case calls into effect a knowing acts exclusionary clause under the same circumstances of this case. In each case, the court has held that the intentional act or knowledge of falsity exclusion does not apply to bar a duty to defend because there is no scienter element in a trademark/trade dress claim. *Hyman, supra, Bay Elec. Supply, Inc. v Travelers Lloyds Ins. Co.*, 61 F Supp 2d 611, 619 (SD Tex, 1999), *Elcom Techs. v Hartford Ins. Co of Midwest*, 991 F Supp 1294, 1298 (Utah, 1997), *Union Ins. Co. v The Knife Co., Inc.*, 897 F Supp 1213, 1217 (WD Ark, 1995). *State Auto, supra, Cat. Internet, supra, Gemmy Industries, supra, R.C. Bigelow, supra*. The 7th Circuit can be added to this list as a result of its holding in *Cincinnati Ins, supra*. Although the case involved claims of defamation rather than trademark/trade dress infringement, the same exclusion as is involved in the instant case was analyzed and rejected.

Under federal law, and in view of the requirements (or lack thereof) of the Federal Rules of Civil Procedure, it would not have been necessary for Flowserve to prove that Pro-Seal acted with any particular knowledge in order to recover for trademark/trade dress infringement, to recover under the Lanham Act or to recover under the Alaska Unfair Competition Act. All that Flowserve needed to prove was that Pro-Seal used a trademark or trade dress which was similar to the trademark or trade dress used by Flowserve, and that there was public confusion as a result. Scierter is irrelevant to recovery. Knowledge is irrelevant to recovery.

If Flowserve had been able to prove inadvertent, negligent or reckless infringement, then they would have been entitled to recover. If they had proved an intentional infringement, then their damages could have been enhanced. Inadvertent, negligent, reckless and intentional infringement are all theories of recovery which are contained within the Flowserve Complaint. In some sense, inadvertent, negligent and reckless infringement are the lesser included offenses, and even though Flowserve alleges intentional acts in some paragraphs, they allege acts without any particular description of intention in others. (Compare for instance paragraph 31, 35, and 40 which contain no reference to intention with paragraphs 20 and 21 which do.) Flowserve would have received jury instructions that state that the Lanham Act, the trademark statutes, the law concerning protection of trade dress, and unfair competition under the Alaska statute do not require a finding that there was prior knowledge, intention or fraud. Flowserve would have been allowed to present evidence that the alleged infringement was committed without any particular intention and would have recovered their damages if the evidence was sufficient merely to show an innocent, negligent or reckless infringement.

The reason that Flowserve did not need to set out separate theories of recovery including

intentional, negligent or innocent acts is that pleadings in federal court are simply “notice” pleadings. It is not necessary to plead a claim that would be cognizable under Michigan Court Rules. It is not necessary to plead a legal theory. All that is necessary is a factual statement of a claim. For instance, in *Cincinnati Ins, supra*, the 7th Circuit rejected arguments that allegations of intentional acts (defamation) in a complaint required application of an exclusionary clause barring coverage for acts committed with knowledge that they would violate another person’s rights. The Court noted that the claims of intentional acts were nothing more than a “pitch” and allegations of deliberateness would be mere “icing on the cake” meant to enhance damages, but that the mere allegation would not cause the application of the exclusion. Likewise the Federal Circuit Courts in the 3rd, 4th, 5th, and 11th Circuits, as cited above, have held that allegations of an intentional or knowing act does not result in the application of an knowing acts exclusionary clause because federal rules of pleading encompass all legal theories of recovery that are applicable to a given set of facts.

Obviously, a complaint is a document drafted by an advocate. Flowserve’s objective in making allegations of *mens rea* in the context of this case was exactly as the 7th Circuit observed; to enhance the claim for damages and make it appear that Pro-Seal was some kind of rogue and reckless company and, although they successfully defamed Pro-Seal, the Flowserve strategy failed when Pro-Seal would not fold, and it was Flowserve, not Pro-Seal that was defeated.

The exclusionary clause to which the Court of Appeal referred in rendering its decision is found in coverage B, section 2 and states as follows:

2. Exclusions.

This insurance does not apply to:

a. “Personal and advertising injury”:

- (1) Caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict “personal and

advertising injury;”

The first aspect of the exclusionary clause that should be noted is that it calls for a subjective analysis of what the insured knew and intended because the criterion it specifically establishes is based upon the knowledge of the insured and not the expectations of the hypothetical reasonable person. The second aspect is that the exclusion would require two findings of fact on which Citizens would have the burden of proof. The first finding required is that the insured acted with knowledge that its acts would violate the rights of another, and second, that the insured knew that the act would inflict a personal and advertising injury.

The Court in *SMDA v American Insurance Co*, 225 Mich App 635, 658; 572 NW2d 686 (1997) dealt with the same matter and analyzed the issue as follows:

Myriad cases decided after *Freeman/DiCicco* have addressed this distinction between objective and subjective language. For example, in *Auto Owners Ins Co v Harington*, 212 Mich App 682, 685-686, aff'd 455 Mich 377 (1997) this Court applied a subjective standard because the policy language provided that damage was not covered when “**expected or intended by an insured person.**” (Emphasis added) In contrast, this Court used an objective standard when a policy stated that coverage was not provided for damage “which may reasonably be expected to result from the intentional acts of an insured person or which is in fact intended by an insured person.” *Allstate Ins. Co v Keillor*, 203 Mich App 36, 39-40, modified on other grounds, 450 Mich 412 (1995).

The language used in the exclusionary clause would require a finding that Pro-Seal violated Flowserve’s trademarks with the specific knowledge that it would cause a “personal and advertising injury.” In order to make such a finding the court would be required to make a finding of fact. The trial court did not make any findings of fact, and took no evidence. Certainly the fact that Pro-Seal denied that it had any intention to infringe on any Flowserve right should have been entitled to some weight in the context of a civil action which raised claims upon which a recovery may have been

granted without the proof of any intentional conduct. *Shuler v Michigan Physicians Mut. Liability Co.*, 260 Mich App 492; 679 NW2d 106 (2004), *Auto Club Group Ins Co v Daniel*, 254 Mich App 1 (2003) See also, *Allstate Insurance Co v McCarn*, 471 Mich 283 (2004), updated March 3, 2005.

The clear meaning of the language used to define the exclusion is that it applies only when the injury is caused by the insured with a particular and prior requisite subjective knowledge. It is a narrow exclusion. It is not the same, and is quite different from stating that the exclusion applies to injuries in which it is “alleged” that the insured caused the injury with the requisite prior knowledge. Citizens argument ignores this distinction. There is a vast difference between alleging that a person has knowingly violated the rights of another and caused an injury, and actually determining as a matter of fact that the insured knowingly violated another’s rights and caused the injury. There is also a difference between analyzing the scope of coverage in an insurance policy, which begins with looking at the allegations of a complaint, and analyzing the scope of an exclusion which depends in this case on a subjective determination of the insured’s actual, as opposed to alleged, knowledge. In this case, in order to find that the exclusion applies to Pro-Seal, Citizens has the burden of proving that Pro-Seal caused the injury with the actual and subjective knowledge that they were violating Flowserve’s rights and knew that they were causing an advertising injury when they sold their products and services. The holding in *SMDA, supra*, makes this point abundantly clear. An allegation made by a third party is not proof that the insured acted with knowledge. It is simply an allegation.

The relevant inquiry for a court to make where an insurance company requests the application of an exclusionary clause for intentional, fraudulent or criminal conduct is twofold. First, does the only possible basis of recovery require proof of an intentional, fraudulent or criminal conduct? In

this case that question would have to be answered in the negative for the reason that Flowserve could have recovered for trademark, trade dress or Lanham Act violations without any proof of intention or scienter. Second, the exclusion could apply where the insurance company proves that the intentional, knowing or criminal conduct alleged actually occurred, not whether it was merely alleged. *Shuler, supra, Auto Club Group, supra, Allstate Insurance, supra.* An allegation that a person intended to do or perform an act, such that an intentional tort may be alleged, is not the same as knowledge that an act will result in the violation of a person's rights and the infliction of a "personal and advertising injury." This latter issue is explored in *Cavalier Mfg Co v Wassau*, 211 Mich App 330 (1995).

It is also important to recognize the context in which coverage is provided for "intentional torts" under both policies. Section V, paragraph 14, of the commercial policy specifically states that the insurance policy covers such claims as false arrest, false detention or false imprisonment, malicious prosecution, the wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling, or premises that a person occupies, committed by or on behalf of its owner, landlord or lessor, the oral or written publication of material that slanders or libels a person or organization or disparages a person's or organizations's goods, products or services, the oral or written publication of material that violates a person's right of privacy, the use of another's advertising idea in an "advertisement", and infringing upon another's copyright, trade dress or slogan in an "advertisement."

In the context in which the coverage is granted under the insurance policy, it is clear that some element of intention would have to be included in any complaint. A cause of action for each of the listed examples requires an allegation that the act was committed intentionally, and yet

coverage is specifically afforded under the policy. However, as the court in *Cavalier, supra*, explained, an intentionally caused act and an intentionally caused injury, which is the criterion that must be applied to activate the exclusion, is not the same as the element of intention that is required to set out a cause of action for slander, libel, false imprisonment, trademark/trade dress infringement or any of the other torts for which the policy provides coverage. For instance, the intention to say words that constitute slander is not the same as the intention to violate a person's rights and inflict a "personal and advertising injury." Indeed, it is likely that a person accused of slander will deny that the words were uttered or that even if uttered, that they were true. Under this scenario, the exclusion would not be applicable. However, if Citizens' arguments were correct, then there would be no coverage for slander even though the policy specifically states that there is coverage for slander. Citizens cannot have it both ways.

If the exclusionary clause were interpreted to mean that all coverage of alleged intentional acts were prohibited, then the coverage provided in section V, paragraph 14, would be illusory and the basic rules of construction would be violated. Indeed, strategic pleading, which may be designed by large companies when attacking small companies, to structure a complaint in a way that disguises its true nature would become determinative and the question would be one of gamesmanship. In *Cincinnati, supra*, the court stated as follows at 745:

But neither tort is named in the Counterclaim. No matter. Coverage does not depend on the characterization of the wrong by the plaintiff (in this case counter-plaintiff, Midwest). Modern pleading requires the pleading only of a claim, not of a legal theory; and so if a specific tort or other legal wrong named in the insurance policy has to be named in the suit for liability coverage to exist, insurance protection could be lost as the result of a totally inconsequential omission by the drafter of the complaint. Such a rule would also be an invitation to strategic pleading.

Strategic pleading in this context has as its objective the avoidance of insurance coverage by

disguising the cause of action. In litigation initiated by large companies against small companies, one of the objectives is to use the superior economic resources of the large company to intimidate the smaller company in what can be crushing legal fees.

A specific inclusion takes precedence over a general exclusion. In a very similar situation, the court held in *Royce v Citizens Ins. Co.*, 219 Mich App 537, 544; 557 NW2d 144 (1996) that the intentional acts exclusion did not apply to a claim of slander of title. Citizens argued in that case that the exclusion for intentional torts operated to bar a claim for slander of title, an intentional tort. The court stated as follows:

Defendant misapprehend the effect of this modification. By including several intentional torts with the definition of damages, defendant negated the applicability of the general rule of non-liability for such torts. Because the endorsement modifies the general policy by the inclusion of coverage for the named intentional torts, its terms prevail.

When the Defendant in *Royce* filed its lis pendens to block a sale of property, there was certainly an intention to commit the act of filing. However, there may not have been an intent to injure. Indeed, the Defendant in *Royce* probably believed that they were acting within their rights in taking the action that they had taken. There is a difference between an act committed with the knowledge that it will result in a violation of the rights of another and an injury to another person, and an act taken in the belief that the actor is justified under the law to protect its interests or promote its business. Citizens' argument attempts to convince the court that there is no distinction between an intention to injure and an intention to take a lawful act if the person who may object to the act alleges that the act constituted some type of intentional tort. If this were the law, then business insurance would be non-existent.

The insurance policies issued by Citizens are business policies. They are not issued just for

accidents or acts of negligence, but are issued to provide protection for a business against claims that occur between businesses. Trademark/trade dress and Lanham Act claims occur between businesses. Lawsuits between businesses are not generally based on inadvertent acts. Commercial litigation is not generally based on negligence. It is based on allegations of intentional acts. They are not acts that are intended to injure, but they are intentional acts nonetheless. The umbrella policy provides for coverage against any claim that Pro-Seal misappropriated another's style of doing business in the course of advertisement. A "misappropriation" will always have some element of intent. The umbrella policy does not limit its coverage to negligent misappropriation. Indeed, the words "negligence" or "inadvertent" are never applied to the list of intentional acts for which coverage is provided in either the commercial or the umbrella policies.

What typically happens in cases like the instant one, is that the insurance company defends the action under a reservation of rights that would allow it to deny indemnification in the event that an intentional course of fraudulent conduct was shown. This is one of the differences between the duty to defend and a duty to indemnify, and it is an example of how the duty to defend is broader than the duty to indemnify. *Radenbaugh, supra*.

Under the circumstance, the decision of the Court of Appeals finding that the exclusionary clause was inapplicable is clearly correct.

RELIEF

For the reasons set forth above, Pro-Seal requests that the application of Citizens be denied.

PIERCE, DUKE, FARRELL & TAFELSKI, PLC

Dated: January 6, 2006

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